United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-1982

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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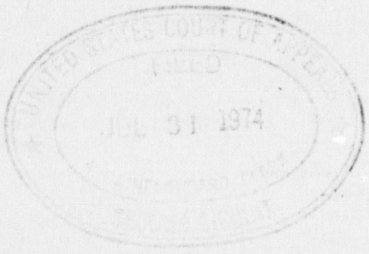
In the Matter -of- MAY LEE INDUSTRIES, INC., Appellant. (In Proceedings for An Arrangement, No. 74-B-166	Docket No. 74-1982

BRIEF FOR APPELLANT, TRUSTEE ON APPEAL
FROM ORDER OF DISTRICT COURT



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STATEMENT OF THE CASE

Pursuant to the Bankruptcy Act Sec. 24, 25 (11 U.S.C. Sec. 47, 48) and the relevant provisions of the United States Code, the Appellant, May Lee Industries, Inc., the Debtor-in-Possession, (hereinafter, the "Appellant") having filed a Notice of Appeal and pursuant to the Order of the United States Court of Appeals regarding this Appeal, appeals from the Order and the Opinion of the Honorable Robert Ward of July 19, 1974 of the District Court for the Southern District of New York and the Order of the Honorable John J. Galgay, Bankruptcy Judge, of June 14, 1974 and the Opinion and Supplementary Opinions of Judge Galgay of May 17 and June 10, 1974, respectively.

DEVELOPMENT OF THE CASE

Pursuant to the petition of the Appellant of February 11, 1974, an Order was signed under Chapter XI of the Bankruptcy Act authorizing the Appellant to operate the business of the Debtor as Debtor-in-Possession, said Order being signed by the Honorable John J. Galgay, Bankruptcy Judge. Thereafter an initial hearing was held on February 19, 1974. On March 14, 1974 the Chartered Bank petitioned for reclamation of certain allegedly secured property and on March 27, 1974 Chemical Bank petitioned for reclamation of certain allegedly secured interests. Answering affidavits were filed by May Lee to the Chartered Bank petition and to the Chemical Bank petition, and thereafter the Chemical Bank and Chartered Bank filed a Brief and May Lee Industries filed a Reply Brief to Chartered Bank's petition and a Reply Brief to Chemical Bank's petition.

Hearings with regard to the petition of Chartered and Chemical Banks were held on April 9 and April 19, 1974 and an Opinion was rendered by the Court on May 17, 1974 and a Supplemental Opinion on June 10, 1974, pursuant to a motion for a rehearing and a rehearing on June 7, 1974. An Order was signed on June 14, 1974 permitting Chartered Bank and Chemical Bank to reclaim certain property pursuant to said Order, and thereafter application was made to stay enforcement of said Order by May Lee on June 17, 1974. After a hearing was held on June 18, 1974, an Order was entered on June 20, 1974 staying enforcement of said Order.

Thereafter the Appellant appealed to the District Court and pursuant to a hearing, a stay was granted pending a decision and that stay order was modified after hearing on the application of the Appellant.

On the 19th day of July, 1974, the District Court rendered a decision and issued an order, which is now appealed from, said order affirming the Opinions of May 17 and June 10 and the Order pursuant thereto of the Bankruptcy Court dated June 14, 1974. This appeal is from the decision and order of the District Court of July 19, 1974, and since said decision and order refer back to the order of June 14, 1974, of the Bankruptcy Judge, also from that order and the Opinions upon which that order is based, namely those of May 17 and June 10, 1974.

FACTS

I. SEQUENCE OF EVENTS LEADING TO CHAPTER XI.

The Appellant, a corporation formed in 1970, became very active in the field of Chinese-American trade in 1972. The Appellant performed two functions, namely acting as a wholesale distributor of Chinese carpets and giftware and acting primarily through subsidiaries as an agent for numerous American corporations wishing to do business with China. The Chartered Bank, was designated by China as one of the few banks that could do business with China in the United States. The Appellant entered into a relationship with Chartered Bank wherein Chartered Bank financed some of the inventory of the Appellant. Other banks also financed some of the inventory of the Appellant. Pursuant to said financing the Appellant, prior to receiving monies for the inventory, was presented with a trust receipt to sign, generally brought to the Appellant by a runner from the Chartered Bank. These trust receipts are alleged by Chartered Bank to be the security agreements under which they claim a lien on a part of the Appellant's inventory.

The Appellant, with the knowledge of Chartered Bank, entered into discussions with a major American corporation, to continue the financing of the Appellant. Negotiations of a detailed agreement took place over approximately a five- to six-month period. All terms were agreed to but because of internal corporate reasons of the potential investor, the corporation that was going to provide May Lee with additional financing, withdrew at

the last minute from the agreement. At that point May Lee's financial situation was seriously weakened by reliance upon the initial negotiation and it attempted to acquire monies from other sources with knowledge of Chartered Bank. It was unable to do so and as a result of the depressed capital market conditions it was inconceivable that a secondary offering could be made of the Appellant's stock. The Appellant, being pressed by its creditors, examined various alternative possibilities of rearranging its financial conditions.

II. PRIOR INFORMATION ON CHARTERED BANK'S FILING OF FINANCING STATEMENT IN NEW YORK COUNTY.

As a result of information it received from a creditor of May Lee, the original debtor was notified that the Chartered Bank had not filed a financing statement in New York County or at least none was to be found in the file. This was testified to and uncontradicted at the hearing of April 19, 1974, at page 57, line 16, where it was stated by an officer of the Appellant that prior to May Lee checking the New York County Registrar's files:

> I had received a telephone call prior to her going there by a third party creditor, a creditor of the corporation, who indicated that he had made a search and he only found Chemical Bank filing and the David C. Buxbaum, Dr. L. M. Greenberg filing.

The Appellant had its own employee check the files as has been testified to by Laura Santangelo with the help of the employees of the New York County Registrar's office and as is found in her affidavit dated April 19, 1974, and part of the Appellant's evidence at the New York County Registrar's

office, and found there was no financing statement in New York County filed by Chartered Bank. In addition, the original attorneys for the Appellant, Arutt, Nachamie & Benjamin, had Inter-County Clearance Company, 299 Broadway, New York, New York 10007, a specialist in these matters, check the filing under the debtor's name and the prior name. Said filings were checked on February 11, 1974, before the petition for an Arrangement was filed, and indicated that there was no Chartered Bank filing in New York County. (See affidavit of David C. Buxbaum and attachment thereto of April 19, 1974, and appendix thereto, and see affidavit of Laura Santangelo dated April 19, 1974.)

As testified to by Mr. Buxbaum in the hearing of June 7, 1974, at pages 18 and 19:

> . . . one of the reasons we considered going into Chapter XI was that we honestly believed and with good reason believed that Chartered Bank was not a secured party.

As further asserted by Mr. Buxbaum, they had good reason to believe that Chartered Bank was not a secured party because:

> . . . our attorneys had checked the record -- didn't check it themselves but they had an independent agency that specializes in checking in these records, check the records and I have been informed by a third party that there was no filing in New York County and there was -- I had a conversation, as a matter of fact with someone at Chemical Bank with regard to this very matter prior to our going into Chapter XI and we discussed this.

In addition the Court wrongfully excluded testimony from the hearing of April 19, 1974 with regard to a conversation David Buxbaum, the President

of the Appellant, had with Mr. Macrae, chief officer of Chartered Bank, regarding the security interests of Chartered Bank, at pages 58-61:

Q Did you thereafter see any further searches that were made?
A Yes, I received a copy of a search made by Inter-County.
Q Did that reveal a filing?
A That also revealed that Chartered Bank had not filed in New York County.
MR. McCULLOCH: I move to strike that as a conclusion.
THE JUDGE: I will allow it.
Q Did you thereafter have a conversation with any officer of the Chartered Bank?
A Yes.
Q With whom, sir?
A With Mr. McRae.
Q Did he identify himself to you?
A Not in that conversation, but I had numerous previous conversations with him.
Q Did you know what position he had with the Chartered Bank?
A I believe he is the chief officer of Chartered Bank in New York.
Q When did you have your conversation with him?
A It was subsequent to these events, some time in March.
Q Of what year?
A 1974.
Q Can you tell us what he said to you and what you said to him in that conversation?
A Relevant to this matter, Mr. McRae told me that his attorneys had been up to the Registrar's officer in New York County.
MR. McCULLOCH: I move to object to all this. This is purely hearsay testimony.
If he is trying to testify about what McRae told him he is trying to introduce the part of the truth that Mr. McRae told him. It is hearsay.
MR. SCHWARTZ: Not where the --
THE JUDGE: It is hearsay.
Why haven't you produced Mr. McRae?
MR. SCHWARTZ: Mr. McRae is a representative and officer of the petitioner, Chartered Bank.
THE JUDGE: You can subpoena him.
MR. SCHWARTZ: I respectfully submit any testimony in connection with conferences had with any representatives of the petitioner is admissible.
MR. McCULLOCH: That is not true. That is not an exception to the hearsay rule.

MR. SCHWARTZ: We are not here on --
THE JUDGE: We are fighting about something that is already in front of me. It is in an affidavit what Mr. McRae is supposed to have said. But it is hearsay, I am not going to allow it.

Immediately upon entering the Chapter XI proceedings a meeting was held with Chemical Bank and Chartered Bank in an attempt to work out an arrangement but none seemed possible at that time. There was an exchange of letters between the attorneys for Chartered Bank, Hawkins, Delafield & Wood and the original attorneys for the Appellant, Arutt, Nachamie & Benjamin on the first entering into the Chapter XI proceedings whereby the Appellant's attorneys indicated that they did not believe that Chartered Bank was a secured party. In addition, at a hearing held on February 19, 1974 before the Honorable Judge John J. Galgay, on page 6 of the transcript the attorneys for the Appellant stated:

> I am not satisfied, though they are listed as secured creditors, that they have an overwhelming position. I believe they may be vulnerable.

The attorneys for the Appellant were, of course, referring to both Appellees, Chartered and Chemical Banks. As pages 7 and 10 of the transcripts of the hearing of February 19, 1974 will indicate, the attorneys felt there was extreme doubt that the alleged security interests of Chartered Bank and Chemical Bank had been perfected.

At all times during the various hearings on the above matters no evidence was ever introduced to indicate that a financing statement by Chartered Bank was ever found in the files of New York County prior to May Lee going into Chapter XI proceedings. There was introduced into

evidence a document purporting to be the original filing in New York County by Chartered Bank. After May Lee was in Chapter XI proceedings there is no doubt that a financing statement was found in the files relevant to Chartered Bank as attested to by the Appellant's employees.

III. APPELLEE CHARTERED BANK'S ALLEGED SECURITY AGREEMENTS

During the various hearings with regard to Appellee Chartered Bank's alleged secured interest, Chartered Bank initially presented its petition with a very large selection of trust receipts attached thereto and various other documents attached to said trust receipts. Thereafter said trust receipts were introduced into evidence, at times with other documents attached to them.

There was uncontradicted testimony at the trial regarding these matters that at the time of the signing of the trust receipts there were never any documents attached to them.

> (Testimony of David C. Buxbaum, hearing of April 19, 1974, pages 62-63, lines 24-25, 3-8):
>
> Q I am not asking you to testify as to which specific trust receipts had any invoices. The question is, were any invoices attached to any trust receipts?
> A Was there ever an invoice attached to a trust receipt at the time it was presented to us?
> Q Yes.
> A Not to my recollection.

Although not entirely clear, the testimony of the Chartered Bank's own employee seems to support that of the Appellant in the hearing of April 9, 1974, on pages 55-56, lines 22-25, 3-11 of the transcript:

Q I note that among the papers that you hold in your hand there are a number of attached pieces of paper such as in the case of the one that is on top, a piece of paper bearing some handwritten notations.

A Right.

Q Was that document submitted as part of the document signed by May Lee, that piece of paper there or is that part of the bank's internal records?

A Internal, when an item is due and it is not paid, we usually extend it, you know, put it down for a new due date.

The Appellant asserts that the Court hereinbelow wrongfully did permit the documents to be entered into evidence. Said objections were made, for example, at the hearing of April 19, 1974, on pages 20, 25 and 26 where counsel for the Appellant stated:

> I would object to the introduction in evidence of any of these trust receipts and customs forms as in no way being connected with the case. They were not referred to in the security interests at any time, which simply refers to documents of title. It certainly does not refer to customs forms which identify the items.

The reason customs forms were mentioned was because customs forms are attached to some of the trust receipts. As the transcript will show, there were numerous problems with regard to attempting to clarify the trust receipts introduced into evidence and the varied attachments thereto that were made by Chartered Bank at their own initiative long after these documents had been signed and filed.

IV. APPELLEE BANKS' REFUSAL TO IDENTIFY INVENTORY TO WHICH THEIR ALLEGED LIENS APPLY.

The position of Chartered Bank and Chemical Bank throughout these hearings and appeals has always been consistent in that they state there is no need to prove what goods belong to them as the assertions of

Mr. McCulloch, attorney for Chartered Bank stated at the reclamation hearing of April 9, 1974, on pages 11-13, commencing on line 5, page 11:

> MR. McCULLOCH: I would like first to say that we recognize on behalf of Chartered Bank that the Chartered Bank's security interest consists of its ability, if it were standing alone, it would rest on its ability to identify separate goods in May Lee's position [sic] as being those covered by special trust receipts.
>
> As a matter of law, that seems to be indisputable. However, our position in this particular case is that the Chemical Bank has a different kind of security interest. It has a blanket security interest covering all accounts receivable except those in which the Chartered Bank has a security interest ahead of them.
>
> The way we propose to approach this thing is to avoid taking up the time of the Bankruptcy Court for the purpose of deciding between Chemical Bank and Chartered Bank which goods are subject to whose lien, because we would concede for the purposes of this proceeding that the Chemical Bank is entitled to all inventory and we would prefer to agree separately with the Chemical Bank as to whether any or all of it actually belongs to the Chartered Bank.
>
> It would relieve the Bankruptcy Court of having to make a decision on that particular question, because I don't see that it makes one single bit of difference to any of the creditors if Chartered Bank were to relinquish its own rights; the whole inventory would belong to Chemical and I don't see any creditor could get at it.
>
> If we could get to an agreement which we propose to do by stipulation to file with the court with the Chemical Bank, that those two banks will among themselves privately divvy up the sale proceedings or the inventory equitably between them.
>
> That's the way we'd like to proceed and it's very simple.

The Banks together have argued that whatever Chartered Bank did not have a lien upon Chemical Bank had a lien upon. It should be noted that neither the Bankruptcy Judge in either his two opinions or order of June 14, 1974, nor the District Court Decision and Order of July 19, 1974 support the Appellee banks on this point.

The Appellees maintain this position despite the fact that both the alleged security agreement and the original overall alleged contract

under which the alleged security agreement was signed with Appellee Chemical Bank on April 23, 1973, contain the following clauses:

> Chemical Bank's security agreement:
>
> > Anything herein to the contrary not withstanding, Collateral "shall not include any of the above described property in which the borrower has granted a 'Security Interest' to the Chartered Bank under a financing statement filed with the Secretary of State on December 4, 1972 under filing number 131128, nor any property of the type described above in which the borrower may, after the date hereof, give a 'Security Interest' to others for inventory, letter of credit and resulting acceptance financing."

Pages 2 and 3 of the Chemical Bank Exhibit C, show that May Lee agreed to grant Chemical Bank a security interest in various property

> . . .except that in which it has granted a security interest to the Chartered Bank under a financing statement filed with the Secretary of State on December 4, 1972, under filing no. 131128, and except for security interests which may required in the future for inventory, letter of credit and resulting acceptance financing.

Furthermore, their position is maintained despite the fact that the banks have entered the premises of the debtor pursuant to court order to inspect and catalogue the inventory.

V. CHEMICAL BANK AGREEMENT

Appellee Chemical Bank had lent money to May Lee Industries on an unsecured basis from time to time and continued to lend some monies to May Lee Industries, the debtor, on an unsecured basis. As a result of an error by the Bank in depositing certain monies in the account of the debtor which the debtor reasonably believed were deposited pursuant to a loan and as a result of the departure from Chemical Bank of the loan officer who had handled the debtor's account, Chemical Bank decided that it wished to convert

its unsecured loans into what it hoped would be secured loans. In order to facilitate this action as uncontradicted testimony will show, Chemical Bank used coercion in an attempt to get May Lee Industries to sign the agreement of April 23, 1973. For example, the uncontradicted testimony at the hearing of June 7, 1974 by David C. Buxbaum on page 30, lines 3-8, indicated the following:

> And secondly, I would point out to the Court, and since I am under oath, I would make this point, that one of our allegations is that the bank used duress in obtaining these signatures against the corporation.

Chemical Bank threatened the debtor with economic ruin and put extraordinary pressures upon it to get it to sign the document of April 23, 1973, which is Appellee Chemical Bank's Exhibit C, and that document gave Chemical Bank possession of the securities of the two leading shareholders of the debtor and therefore put Chemical Bank in essence in control of the debtor, granted Chemical Bank warrants for the debtor's stock, gave Chemical Bank control over the working capital of the debtor, permitted Chemical Bank to control the salaries of officers of the debtor, allowed Chemical Bank to obtain alleged personal guarantees and a Confession of Judgment from leading officers and directors of the debtor, required the debtor to report its financial condition to Chemical Bank periodically, required other lenders to subordinate their interests to Chemical Bank, and allegedly gave Chemical Bank a security interest in certain assets of May Lee, the debtor.

VI. LACK OF MEETING OF MINDS ON SECURITY AGREEMENT

In fact, however, the security agreement which was introduced into evidence, unlike the other documents that were introduced into evidence, was uninitialed in a number of places by the officer of Chemical Bank. Only certain portions of that security agreement were initialed. The uncontradicted testimony was that the agreement was first sent by the Bank to May Lee, the debtor, for signature. The debtor thereafter made some changes, initialed the changes and signed the agreement. Thereafter the agreement was returned to the petitioner Chemical Bank who initialled only portions of the security agreement and did not initial other portions.

The uncontradicted testimony by an officer of May Lee is as follows, as found in the hearing of June 7, 1974 on pages 20-21, commencing on line 16, page 20:

> The actual transaction took place in this form.
> This security agreement was prepared by the bank. This alleged security agreement.
> It was sent to May Lee Industries. We examined it, we made some changes in it, we initialed those changes, and sent them back to Chemical Bank.
> Chemical Bank did not initial those changes. In terms of contract law, we might analogize it to an offer by Chemical Bank, a counter offer by May Lee, and no acceptance by Chemical Bank.

VII. THE UNCONSCIONABILITY AND LACK OF CONSIDERATION OF THE CHEMICAL BANK AGREEMENT.

As noted hereinabove, in view of the contract of April 23, 1973, and the security agreement thereto, and in view of a number of other legal

questions that will be more fully argued in the argument hereinbelow, the attorneys for the Appellant raised questions very early in these proceedings and in fact questions were raised with Chemical Bank prior to the Appellant entering Chapter XI proceedings, as to the binding nature of the agreement which allegedly would make Chemical Bank a secured party. The Appellant's position was that while it was bound by the contract of April 23, 1973, to do many things and in fact to in effect put itself in the hands and under the control of petitioner Chemical Bank, and to have its officers personally liable to Chemical Bank, the Bank bound itself to nothing because the uncontradicted testimony is that the financial situation of May Lee Industries, Inc., the Appellant, was never good throughout this period and the Bank could, pursuant to the terms of the agreement, call its loan at any time. Therefore the loans remained demand loans without any real consideration. The testimony by an officer of May Lee reads as follows on pages 25-26 of the hearing of June 7, 1974, commencing on page 25, line 14:

> On the one hand, we would feel that the status of May Lee Industries, from a hard accounting point of view at any point, during the signing of this agreement or prior to it and thereafter, was not a good one.
>
> Chemical Bank could have deemed itself insecure any time it wanted to. It had perfect freedom to.
>
> Furthermore, it could deem itself insecure of Buxbaum and Greenberg, and did something to increase its credit risk, and my going out and buying a car, or doing anything in that nature, or Dr. Greenberg doing that, would increase its credit risk.
>
> We would say, as a result of these paragraphs, that Chemical Bank bound itself to nothing, and that at any time it wished to call the loans, it could have.

Since the agreement allowed the Appellee, Chemical Bank to call its loan at any time, it ". . .reasonably deemed itself insecure", and since the debtor

had a negative net worth during all times commencing prior to the signing of the agreement to date, the Appellee could call the loans at any time.

VIII. ACTUAL CALLING OF LOANS BY CHEMICAL BANK

The uncontradicted testimony also will show that the Bank called the loan on numerous occasions as a coercive measure. For example, see the uncontradicted testimony reported in the hearing of June 7, 1974, pages 33 and 34, commencing on line 4 of page 33, which reads as follows:

> THE JUDGE: They made a demand. You didn't meet it. This is after you went into Chapter XI.
> MR. BUXBAUM: Chemical Bank attempted to call the loan on numerous occasions prior to that.
> THE JUDGE: How long did you operate under this agreement before they did make a demand?
> MR. BUXBAUM: I would believe that Chemical Bank attempted to call the loan within the first four or five weeks of this agreement. It is my recollection.
> THE JUDGE: Do you have any writings to that effect?
> MR. BUXBAUM: No, I have a telephone conversation, which I will be happy to testify to, with at least one party in Chemical Bank.
> THE JUDGE: Why don't you identify them?
> MR. BUXBAUM: With Myron Burmer (phonetic) [Berman] and another gentleman, I also talked to very shortly after this agreement was signed, and there was a claim that we were in default, and they were going to call this loan.
> And I am sorry, because I didn't realize that we were going to have a hearing today on this matter, but there were also letters written to May Lee in the interim, either threatening to call the loan or indicating that there was default under the agreement.
> This occurred frequently, from the date, well, from within four or five weeks of the date of the agreement up until the time of the Chapter XI proceedings.
> This was a frequent occurrence, calls from the bank and some letters.

IX. THE COLLATERAL, IF ANY, TO WHICH THE APPELLEE CHEMICAL BANK'S LIEN ATTACHES.

At various times during the numerous hearings that have been held, questions arose, even assuming the Chemical Bank lien to be valid, as to what goods were covered by the Appellee's alleged lien: The uncontradicted testimony shows that the only thing the Appellee Chemical Bank's alleged lien would apply to is the furniture of the Appellant.

For example see the testimony on page 39, line 9, of the hearing of June 7, 1974, which reads as follows (testimony of Appellant):

> It seems to me that the only thing that an alleged secured interest of Chemical Bank might attach would be the furniture of the corporation. I don't think that could be of any value to or very much value, certainly, to Chemical Bank other than a nominal value, and the corporation would have difficulty in operating without furniture.

X. THE COLLATERAL, IF ANY, TO WHICH THE LIEN OF CHARTERED BANK APPLIES.

The Appellees Chartered Bank and Chemical Bank have both argued that the goods that do not belong to Appellee Chartered Bank belong to Appellee Chemical Bank, despite the phrase in the Agreement of April 23, 1973, and the Security Agreement of that date of Appellee Chemical Bank that specifically excludes from their lien any goods financed by Chartered or other banks.

The inventory of the appellant presently in its possession has been financed by banks other than Chartered Bank, as shown by the uncontradicted testimony by an officer of May Lee found in the hearing of June 7, 1974, on pages 9 and 10, commencing on line 19, page 9:

THE JUDGE: During this entire time was Chartered Bank the only one that was financing the imports into this country from China?

MR. BUXBAUM: No.

THE JUDGE: What other banks were there?

MR. BUXBAUM: National Westminster financed some, Bank of America financed some, and I think there was a third bank, but I don't recall.

THE JUDGE: All right.

MR. BUXBAUM: But, predominantly the goods were predominantly financed by Chartered Bank, but not exclusively.

THE JUDGE: What percent, can you say, if you can?

MR. BUXBAUM: A guess would be seventy-five percent.

ARGUMENT

I. THE APPELLANT IS A TRUSTEE, A SEPARATE LEGAL ENTITY FROM THE DEBTOR.

The Appellant herein is a trustee for the property of the debtor. Sec. 188 of the Bankruptcy Statute reads as follows:

> A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge. . . .

The order of February 13, 1974, signed by the Honorable John J. Galgay, bankruptcy judge, continuing the debtor in possession of its property, consistent with Sec. 188, notes that the debtor-in-possession has the powers of a trustee viz:

> 1. That the debtor shall continue in possession of its property, and shall have all the title and may exercise, consistently with the provisions of Chapter XI of the Bankruptcy Act, all the powers of a trustee appointed pursuant to Section 44 of the said Act, subject, however, at all time to the control of the Court and to such limitations, restrictions, terms and conditions as the Court may from time to time prescribe;

The Appellant is thus a trustee, a new and separate legal entity and not the same legal entity as the debtor. This is a key legal concept for the purposes of this case.

II. THE APPELLANT IS TO BE REGARDED AS A HYPOTHETICAL LIEN CREDITOR.

For the purposes of determining whether or not a creditor of the estate is secured, the Appellant, trustee is treated in law as a hypothetical

lien creditor. For example, the United States Court of Appeals for the Ninth Circuit held in 1972 In the Matter of Burris Haley Thomas 466 F. 2d 51 (1972) at p. 53 in a similar case to the one at bar that:

> However, in litigation of this type a trustee in bankruptcy is treated as an ideal hypothetical lien claimant as of the date of the bankruptcy.

IIA. THE TRUSTEE TAKES PRIORITY OVER ALL UNPERFECTED SECURITY INTERESTS.

Sec. 9-301 of the Uniform Commercial Code, provides that:

> . . . a trustee in bankruptcy takes priority over unperfected security interests in the bankrupt's property. (30 ALR 3d p. 61).

The burden of proof is on the allegedly secured party to prove that their interest is good against the trustee, who in this case is the Appellant, and who is regarded for these purposes as a hypothetical lien creditor.

III. THE APPELLEES CHEMICAL BANK AND CHARTERED BANK ARE CREDITORS OF THE DEBTOR.

The legal questions raised upon appeal and raised throughout these proceedings are not whether or not the Appellees are creditors of the debtor -- for it has been admitted and the Appellant so admits that the Appellees are creditors of the debtor. The only question raised in all proceedings heretofore is whether the Appellees are secured creditors, who would be permitted to reclaim certain assets of the debtor, now under the control of the Appellant-trustee, to the derogation of the rights of other creditors and the trustee.

In order that the Appellees be granted such a preference, they must sustain a heavy legal burden. Even if they fail to sustain that burden, however, and are deemed unsecured, they will still be creditors of the debtor, and would participate with other creditors in either the assets of the debtor -- now in the hands of the Appellant -- or in those assets distributed in an arrangement.

IV. EVEN IF THE APPELLEES ARE BOTH SECURED PARTIES, MUST THEY PROVE THEIR INTERESTS IN THE PROPERTY OF THE APPELLANT, OR CAN THEY MERELY DIVIDE ALL THE ASSETS OF THE APPELLANT BETWEEN THEM?

The Appellees, as noted in the facts hereinabove, have argued throughout these proceedings that all the assets of the Appellant belong to either one or the other of them and therefore there is no need to prove to whom the assets belong.

A. Not All of the Inventory of the Debtor was Financed by Chartered Bank.

As noted above, the uncontradicted testimony at hearings held pursuant to their reclamation petitions, proved that not all inventory of the debtor, to which the Appellant has become trustee, was financed by Appellee Chartered Bank. Therefore, it is incumbent upon Appellee Chartered Bank to prove which assets of the debtor belong to Chartered Bank, even if Chartered Bank is secured.

B. The Appellee Chemical Bank's Agreements Specifically Excludes Rights to Property Financed by Chartered or Other Banks.

The Appellee Chemical Bank, pursuant to its agreements with

the debtor, namely the April 23, 1973 Agreement and the Security Agreement thereunder, contains the provision quoted hereinabove that excludes their interest in goods financed by Chartered Bank or other banks. Since the tangible inventory in the hands of the Appellant were all goods financed by either Chartered or other banks, the Appellee Chemical Bank has no interest in such goods.

The Appellee Chemical Bank and the Appellee Chartered Bank both have argued, however, that if Appellee Chartered Bank's interest fails, Appellee Chemical Bank will succeed to their interest.

This argument is specious. There is no doubt that between the original debtor and Appellee Chemical Bank, there were loans made. Nor is there any doubt as between Appellee Chartered Bank and the original debtor and other banks and the original debtor, there was a valid agreement to finance inventory. As such, Appellee Chemical Bank has no interest in said inventory by the terms of its own agreement.

Whether or not Appellee Chartered Bank has a valid lien as between itself and the Appellant-trustee is not relevant to Appellee Chemical Bank's interest. The Appellant-trustee is in the position of a hypothetical lien creditor for purposes of the Appellee Chartered Bank's alleged interest. The fact that as against the Appellant-trustee, Chartered Bank does not succeed, has no effect upon Chemical Bank. As between a preferred trustee and an alleged lienholder with a delimited lien as against the original debtor, the alleged lienholder, Appellee Chemical Bank, cannot succeed beyond the limits of the terms of its alleged lien.

The Appellee Chemical Bank's original agreement does not specify that it shall have an interest in the goods financed by Chartered Bank and other banks for the debtor, if there is no valid perfected security interest between the Chartered Bank and a trustee, who is a hypothetical lien creditor. It merely states that as between the original entity, May Lee Industries, Inc., and the Chartered or other banks, if a security interest was granted by said May Lee Industries, Inc., then Chemical Bank would have no interest in said collateral. There is no doubt that as between May Lee Industries, Inc., the original entity, and Chartered and other banks there was a valid binding security interest -- since irrespective of the defects in the Appellee Chartered Bank's financing statement and security agreement, the original entity, May Lee Industries, Inc., had knowledge of the fact that a financing statement was filed. This knowledge, however, is not attributable to the debtor-in-possession, the Appellant-trustee.

Therefore, it is respectfully submitted that the Appellee Chartered Bank and the Appellee Chemical Bank, irrespective of whether or not they have valid liens, do not have a lien on all the goods in the hands of the trustee, Appellant.

Furthermore, since both Appellees have refused to prove which goods belong to them as noted hereinabove, but rather have relied upon the assertion that they have all goods, their alleged liens must fail since they have not sustained their burden of proof. Thus, it is submitted, with nothing more, Appellees should not be granted relief and the Opinion and Order of July 19, 1974 of the District Court and the Order of June 14, 1974 of the

Bankruptcy Judge and the Opinions thereto should be set aside and relief granted forthwith to the Appellant.

C. Neither the Bankruptcy Judge Nor the District Court Sustained the Claims of the Appellees that They Have a Lien on All the Goods of the Appellant and Need Not Prove the Specifics of Their Liens.

While neither the District Court nor the Bankruptcy Judge sustained the arguments that the Appellees had a lien on all the goods of the Appellant, neither the bankruptcy judge nor the District Court required the Appellees to prove which goods they have a lien upon. As such those opinions and orders are clearly in error and it is submitted, must be overturned.

V. APPELLEE CHEMICAL BANK'S ALLEGED LIEN HAS NOT RECEIVED CAREFUL JUDICIAL CONSIDERATION.

The courts hereinbelow have given little attention to the question of whether or not Appellee Chemical Bank has a lien on the goods of the Appellant. The reasons for this lack of attention are several. In the first place the uncontradicted testimony is that if Appellee Chemical Bank has any lien at all, it only attaches to furniture in the hands of the Appellant -- therefore, the courts have not pursued this matter with care. In the second place there are several legal questions raised about the Appellee Chemical Bank's alleged lien, that require careful consideration and under the circumstances the courts were apparently reluctant to deal with these issues if Appellee Chartered Bank succeeded to its lien. In fact, the questions about the Appellee Chamical Bank's lien are most significant to the Appellant and to other parties. Appellee Chemical Bank, for example, has already tried

to make use of the decisions hereinbelow in a State Court case where it is being sued for fraud, claiming that the decision collaterally estops the parties from relitigating issues already decided. Therefore, failure to consider and decide these matters in this Court could seriously prejudice the rights of other parties who may be in privity with the Appellant.

Furthermore, the terms of the Appellee Chemical Bank's alleged lien, if sustained, would defeat the entire bankruptcy statute and render it nugatory as a matter of law.

VI. THE CHEMICAL BANK LIEN IS INVALID AS A MATTER OF PUBLIC POLICY.

The District Court devotes three sentences to the Appellee Chemical Bank's alleged lien (pp. 6-7), to wit:

> The Court affirms the Bankruptcy Judge's finding and conclusion that Chemical has a valid, binding security agreement which sufficiently identifies the collateral, for which Chemical gave consideration and which was not unconscionable. This Court is in agreement with the Court below that the fact that Chemical did not initial changes made by the debtor in the proposed security agreement presented to it is of no consequence inasmuch as the Chemical officer signed the agreement after the debtor had made the changes and initialed them.
>
> The Court considers the debtor's remaining contentions to be without merit. [July 19, 1974]

The Supplemental Opinion of the Bankruptcy Judge of June 10, 1974, page 4, devotes five sentences to the matter, to wit:

> After hearing testimony from Dr. Buxbaum, principal officer of the debtor in possession, and examining the document, the Court finds this was a valid binding agreement entered into by the parties; there was a meeting of the minds and was for valuable consideration. The Chemical officer

signed it after the Debtor made changes and initialed them. The fact that Chemical did not initial the changes is of no consequence. . . . One point raised in the reply brief dealt with the issue of unconscionability of some of the terms of the April 23, 1973 agreement (Applicant's Exhibit "C")--Banks are not charitable institutions and traditionally require broad protection of their interests when entering into contracts. The terms of this contract (Applicant Chemical's Exhibit "C") follow that pattern, but it is not unconscionable.

The Order of June 14, 1974, however, devotes a number of paragraphs to the lien describing it as follows on pages 3 and 4 of said order:

> ORDERED, that the Petition to Reclaim Property of the CHEMICAL BANK sworn to on March 26, 1974 be, and it hereby is, granted in all respects; and it is further
>
> ORDERED, that the CHEMICAL BANK has a valid perfected security lien on all collateral which is the subject of its security agreement and Redier [sic] thereto described in Exhibit "A", attached to the Order to Show Cause of the CHEMICAL BANK dated March 27, 1974, including the following collateral and all and any proceeds arising therefrom and all and any products of the collateral:
>
> (A) All inventory and goods of the Debtors, then owned or thereafter acquired, including inventory or goods in transit, and wherever located which are held for sale or lease or are to be furnished under contracts of service, or which are raw materials, work in process, or materials used or consumed in Debtor's business, or finished goods and supplies customarily classified as inventory;
>
> (B) All rights of the Debtor to payments which are to be earned by performance under contracts, then existing or thereafter arising;
>
> (C) All accounts, notes, drafts, acceptances and other forms of obligations and receivables for goods sold or leased or services performed by the Debtor, then or thereafter arising, together with all guarantees and securities therefor and all right, title and interest of the Debtor in the merchandise which gave or shall give rise thereto, including the right of stoppage in transit;
>
> (D) Any other tangible or intangible property then owned or thereafter acquired, including without limitation fixed assets, fixtures and equipment;

and the CHEMICAL BANK is entitled to obtain such collateral;

A. No Limitation as to Time, Extent, Scope or Degree.

This all-embracing language, if actually binding upon the Appellant, would seem to defeat the very purposes of the Bankruptcy Statute. For example, the grant in Paragraph (A) of "All inventory and goods of the Debtors, then owned or thereafter acquired...":

1. Inventory "then owned" is not defined in said order as to time. When does then owned mean?

2. Inventory "thereafter acquired" presumably would mean even after the Chapter XI proceedings began or after they are finished. What debtor or trustee would continue in business and what good would the Bankruptcy laws be if a lien could continue to pursue the debtor forever?

The grant in Paragraph (B) of "All rights of the Debtor to payments. . .earned by performance under contracts, then existing or thereafter arising" would again pursue the debtor forever. How could a debtor rehabilitate himself? How could a trustee protect the property of the debtor?

In addition, Paragraph (C) gives the Appellee Chartered Bank rights to all accounts, notes, drafts and other forms of obligations and receivables for goods or services and Paragraph (D) refers to tangible or intangible property then owned or thereafter acquired.

What is left of the debtor for the trustee? The trustee is merely an employee of Appellee Chemical Bank who works for nothing under the grant of lien found in the Order of June 14, 1974 and reaffirmed by the District Court decision.

The Bankruptcy laws could not protect a debtor if such a lien were permitted and there would never be a chance for rehabilitation. Therefore, such alleged liens are invalid as a matter of public policy and the fundamental principals of the Bankruptcy laws can never and have never been enforced.

In addition, the lien is so unclear that the time period of commencement of said lien and cessation is nowhere defined. Therefore, as a matter of public policy the liens granted by the order of June 14, 1974 to Chemical Bank are void for vagueness.

B. Failure to Delimit Lien in Accord with Contract and Security Agreement of Chemical Bank.

n addition to the extraordinary limitless lien granted by the court, nowhere does the Bankruptcy Judge or the District Court delimit the lien as the actual contract of Chemical Bank of April 23, 1973 and Security Agreement thereunder delimits the lien, namely:

> . . .except that in which it has granted a security interest to the Chartered Bank. . .and except for security interests which may be required in the future for inventory, letter of credit and resulting acceptance financing.

This is a clear limitation in the agreements of Chemical Bank, yet neither court has seen fit to specifically include this in the order, although indirectly by reference to the original petition, the June 14, 1974 order does make some reference to this.

C. Failure of Appellee Chemical Bank to Identify Its Alleged Collateral.

Quite clearly, Chemical Bank has absolutely no interest, if it has any interest at all, in anything that might have been secured by Chartered Bank, nor anything which might have been secured by any other banks.

As we noted hereinabove, the uncontradicted testimony is that banks aside from Chartered Bank have financed some of the appellant's inventory. Therefore, it is obviously incumbent upon Chemical Bank, as it is incumbent upon any allegedly secured party, to prove which collateral, if any, its alleged lien attaches to. Chemical Bank has at no time made offers of such proof. Similar language is found in the alleged security agreement that Chemical Bank has proffered which states:

> Anything therein to the contrary notwithstanding, 'Collateral' shall not include any of the above-described property in which the Borrower has granted a 'Security Interest' to the Chartered Bank under a financing statement filed with the Secretary of State on December 4, 1972, under filing no. 131128, nor any property of the type described above in which the Borrower may, after the date hereof, give a 'Security Interest' to others for inventory, letter of credit, and resulting acceptance financing.

Therefore, irrespective of the validity of these agreements, and the Appellant respectfully submits that these agreements are invalid, Chemical Bank does not have any interest in anything in which Chartered Bank has an interest nor in any collateral which might have been financed in similar fashion by other banks or institutions.

Therefore, it is submitted that Appellee Chemical Bank has no valid lien on the Appellant-trustee's property and that judgment should be rendered forthwith for the Appellant.

VII. THE ORDER OF JUNE 14, 1974 AND THE ENTIRE PROCEEDINGS BROUGHT HEREIN ARE INVALID AS A MATTER OF LAW.

A. . Proceedings were improperly commenced.

The Rules of Bankruptcy Procedure, Rule 701 provide that

> The rules of this Part VII govern any proceeding instituted by a party before a bankruptcy judge to..., (2) determine

> the validity, priority, or extent of a lien or other interest in property....Such proceeding shall be known as an adversary proceeding.

The advisory Committees Notes to Part VII rule 701 indicate that they apply to

> ...reclamation proceedings filed by secured creditors....

Rule 703, 704 and the following Rules of Bankruptcy Procedure, provide the means and procedures whereby a reclamation proceeding may be commenced including the filing of a complaint, summons, notice of trial, pleading, answer, reply, deposition, etc. Almost none of these proceedings for reclamation in this action were followed in accordance with these rules. Over the objections of the Appellant at the hearing on April 9, 1974, these proceedings were brought on by Order to Show Cause and the Appellant was not given a proper opportunity to present his case.

B. The Opinion and Order of the Court was not proper as a matter of law.

Rule 752 of the Rules of Bankruptcy Procedure provides for the court findings. It states·

> (a) Effect. In all matters tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon....

The Opinions hereinbelow do not conform to the requirements of this provision of the law.

For example the Appellant raised the question of the adequacy of the description of collateral in the court hereinbelow in the trust receipts

of Chartered Bank. The Court in the Opinion of May 17, 1974 fails to deal with this matter. The Court barely touches on the matter in its Supplemental Opinion of June 10, 1974, and there its findings of facts, as shall be argued infra, are clearly erroneous. The District Court as shall be shown later merely affirmed a clearly erroneous finding.

The Courts never had any findings with regard to the Appellants assertion that the Chemical Bank agreement was illegal. The Courts barely touch on the matter of lack of consideration as a fact and never discussed the law with reference to the Chemical Bank agreement.

The argument that the Opinion and Orders hereinbelow do not conform to the legal requirements of the Rules of Bankruptcy Procedure is not merely a technical argument. The precise holdings required by the rules, of fact and law, would have narrowed the issues on appeal, perhaps have avoided some litigation and put all parties in a better situation to assess their rights and obligations, something they cannot do at present.

Therefore it is respectfully submitted that this Court should make precise findings of fact and law and that the decisions and Orders hereinbelow should be set aside.

VIII. THE CHEMICAL BANK SECURITY AGREEMENT IS INVALID SINCE THERE WAS NO MEETING OF THE MINDS BY THE PARTIES.

In order for a creditor to perfect a security interest in collateral of a debtor, there must be a valid security agreement between the parties (See Uniform Commercial Code (hereinafter "U.C.C.") Sec. 9-102). Chemical Bank does not have a valid security agreement

and therefore cannot have a perfected security interest in the debtor's assets.

The alleged Security Agreement of the Chemical Bank, and a security agreement is a contract, contains numerous deficiencies including the fact that there was no agreement to the terms of the security agreement.

> In accordance with contract law mutual assent is necessary to have a binding agreement. (1. Williston on Contracts, Third Edition, 1957 & 1973 suppl. (hereinafter "Williston"), Sec. 22, p. 46ff)
>
> ...if any provision is added to which the offeror did not assent, the consequence is not merely this provision is not binding and that no contract is formed but that the offer is rejected. (1 Williston, Sec. 73, pp. 238, 239).

The uncontradicted testimony quoted supra shows that a partially completed unsigned bank form alleged to be the Security Agreement of Chemical Bank, was sent to the Debtor; the Debtor altered certain of the terms and initialed the alterations and singed the purported agreement, thereby making a counter-offer to the Chemical Bank. Chemical Bank did not accept the counter-offer or new offer since it did not initial the changes on page one of the alleged Agreement, the method agreed to for manifesting assent to the counter-offer. Therefore, there was no agreement, no contract and Chemical Bank does not have a valid security agreement. Note that other documents submitted on April 23, 1973 including the overall contract, subordination agreements, and guarantees were initialed in all places.

The Supplemental Opinion of June 10, 1974 holds that:

> The fact that Chemical did not initial the changes is of no consequence. (at p. 4)

The District Court decision of July 19, 1974 on pages 6 and 7 affirms this decision holding that since an officer of Chemical signed the agreement failure to initial is of no consequence. This casual dismissal of a fundamental provision of contract law should not be permitted. Are lawyers merely wasting their time when they require people to initial changes in agreements? Is it not necessary for there to be a meeting of the minds on a document as important as a security agreement. A bank form is generally construed strictly against the preparer of that form - namely the bank. Should not this form also be so construed. While the U.C.C. has modified some of the strict provisions of contract law for commercial sales, such modification does not apply to security agreements which should be strictly construed in accordance with contract law.

If the Appellee, Chemical Bank's security agreement is not a binding agreement, and the Appellant so asserts, then Chemical Bank is not a secured party.

IX. CONFUSED DESCRIPTION OF THE COLLATERAL IN APPELLEE CHEMICAL BANK'S SECURITY AGREEMENT.

Furthermore, the Collateral referred to in Paragraph 3 of said security agreement, is what would be used primarily as "...equipment in business and inventory." Chemical Bank had already advanced the monies here and this agreement merely intended to provide security

for Chemical Bank. The monies were not newly advanced and not for inventory. In the alleged Rider to Security Agreement, the Collateral is described differently as noted hereinbelow. There is therefore a conflict in the agreement and it is invalid. Note that Paragraph 3 merely describes the use of the collateral.

The Rider to the Security Agreement is not shown to be part of it by any overt means. Furthermore, the Rider is not dated as to date but merely as to month, therefore the Rider is not part of the security agreement and the security agreement must fall because it fails to describe the collateral to which it must attach. Page one of the Security Agreement leaves the place for description blank. A Security Agreement must contain a description of the collateral in order to be valid (UCC Sec. 9-203). As noted hereinabove and in the Debtor's Brief of April 4, 1974, p. 4, the security agreement must delineate the precise collateral or type of collateral. The Bank security agreement fails to do this without the Rider. The Rider is not shown to be part of the agreement and therefore there is no valid security agreement and no perfected secured interest.

Even, however, if the Rider were somehow shown to be part of the Security Agreement, it is void for vagueness and violates public policy and the Bankruptcy Laws and does not meet the requirements of the law.

Paragraph 1 of the Rider allegedly belonging to the Security Agreement is limited by a typed addition on the bottom of the page as are

all other paragraphs. Since this is so, one has no idea of the precise collateral involved. There is no description whatsoever that anyone can identify with precision and thus the security agreement is invalid. We do not know if carpets, furniture, or rights are involved and which collateral, if any, Chemical Bank might claim in opposition to Chartered Bank. Since this agreement does not cover all the debtor's assets it must delineate the ones it does cover with precision.

The general Agreement of April 23, Exhibit C of Chemical Bank, purports to be an agreement between the Debtor, Chemical Bank and David C. Buxbaum and Lawrence M. Greenberg. This purports to be the overall agreement between the Debtor and Chemical Bank under which the Security Agreement was prepared. Exhibit C lacks contractual status. There is no relationship between "Rider to Agreement..." on page one of Exhibit C and the "Agreement made this 23 day of April..." which is the remainder of Exhibit C. Therefore there is no unified coherent agreement that can be determined and the party's intent is unknown. No contract exists.

The Courts below did not deal with this issue although it had been raised in several prior briefs.

X. THE APPELLEE, CHEMICAL BANK AGREEMENT LACKS CONSIDERATION.

There is no consideration for the April 23, 1973 agreement of Appellee Chemical Bank which is the overall contract of the Bank and the Debtor. In the "Whereas" clause the April 23, 1973 agreement merely

recites allegedly existing indebtedness and an allegedly existing guarantee and therefore no new consideration flowed from Chemical Bank to the Debtor or to alleged guarantors. Nowhere in this agreement is it alleged that the monies owed were due and payable and that demand had been made and refused. Therefore, even on its face,this agreement lacks consideration and it is void and not binding. The security agreement under this agreement, specified in Para 2, p 2 of Exhibit C & A is also therefore not binding on the parties and falls for lack of consideration. (See also discussion hereinbelow re Consideration).

Even if, however, the contract of April 23, 1973, Chemical Banks Exhibit C, was considered valid, it is void for being an Unconscionable Contract under UCC Sec. 2-302(d) or under the rules of equity. The contract Exhibit C is unconscionable for the following reasons: (1) It lacks consideration since as noted above it recites, in the whereas clause, that it relates to an existing debt of the Debtor and an allegedly existing guarantee. Therefore no new consideration is forthcoming from the Bank to the Debtor. Even if it was held that there was some consideration it is miniscule.

The purported agreement, Exhibit C, states in paragraph 12, numerous conditions of default including subparagraphs XIII, XIX which read as follows:

> (xiii) any change in, or discovery with regard to, the condition or affairs of May Lee, and/or its subsidiaries, Buxbaum or Greenberg which, in Chemical's reasonable opinion, increases its credit risk; or, (xix) if Chemical

in good faith, reasonably deems itself to be insecure.

Thus the mere "deeming itself to be insecure" by Chemical Bank is enough to breach the agreement and make the loans due and payable provided only that it deems itself insecure in good faith.

A discovery by Chemical Bank with regard to the affairs or conditions of the Debtor or either alleged guarantor, or subsidiaries of the Debtor, which increases Chemical Bank's credit risk is also sufficient to make the loans immediately due and payable and the agreement breached. Surely this is unconscionable since the borrowing of ten dollars ($10.00) by Buxbaum, Greenberg or a subsidiary of the Debtor, increases the Bank's credit risk or could be said to so increase its credit risk. Therefore Chemical Bank has bound itself to nothing and there is no contract. In fact Chemical Bank could have deemed itself insecure, in good faith, at any time because there never were tangible assets in the Debtor's possession to cover even a small fraction of the debt to Chemical Bank, before, during or after the loans were made and the Bank could reasonably deem itself insecure at any time. As the uncontradicted testimony showed supra, the Debtor had a negative net worth from a hard accounting point of view and thus the Bank could reasonably deem itself insecure at any time. The testimony also shows that the Bank did that - namely continually threatened or called the loan. Thus the Bank gave nothing that the Debtor did not have before. These loans remained demand loans.

The Debtor, on the other hand, has innumerable new obligations in addition to payment of the existing debt. For example (Exhibit C), a purported security interest is granted of the broadest type, (para 2), monthly financial statements are required (para 3), the Debtor must use best efforts to raise new capital, part of the new capital if obtained goes to Chemical Bank (para 5), the Debtor's overhead is limited (para 6), salaries are limited (para 6), working capital is limited (para 7), and subsidiaries must guarantee obligations of the Debtor (para 8).

In addition the guarantors, who are alleged to be existing guarantors, are required to subordinate an allegedly existing note from the company (para 4), and several parties including one guarantor is required to pledge 113,000 shares of the Debtor's stock to the Chemical Bank (para 9) and another third party must pledge 103,000 shares of the Debtor's stock. The result of this is to make Chemical Bank the leading stockholder of the Debtor, controlling more that 223,000 shares, plus having an option to obtain 30,000 additional shares (para 15). Therefore Chemical Bank held more shares of the Debtor than the public (almost twice as many) and probably four times the number of shares of the next leading shareholder even without exercising its options.

In addition Chemical Bank demanded the signing of a Subordination Agreement by two guarantors and a Confession of Judgment by one guarantor, David C. Buxbaum. The Chemical Bank thus controlled the salaries, monthly expenses, number of employees, working capital, the controlling shares of the Debtor, and had control over the guarantors, and

merely had to deem itself insecure or in its opinion feel that some change has increased itscredit risk and the agreement was breached. All this for antecedent debts and purported prior agreements. This is an unconscionable agreement under the U. C. C. 2-302(1) or more properly under normal rules of equity, even if there was consideration. In fact Chemical Bank bound itself to nothing and there was no consideration.

> The requirement of a sufficient consideration for a promise is not satisfied by a pretense that there is a consideration when in fact there is none. A nominal consideration is not a sufficient one, if we mean by nominal that the stated consideration is a pretense and not a reality. (Corbin on Contracts, 1 vol. ed., 1952 p 189 (hereinafter "Corbin")).

> There is sufficient flexibility in the concepts of fraud, duress, misrepresentation, and undue influence, not to mention differences in economic bargaining power, to enable the courts to avoid enforcement of unconscionable provisions in long printed standardized contracts, in part by the process of "interpretation" against the party using them, and inpart by the method used by Lord Nelson at Copenhagen. (Corbin, p 188)

Here we have a typical long form agreement of the type Corbin refers to. In addition the requirements of options makes the interest rate on this loan exhorbitant and while the laws of usury may not apply to corporations a court may consider whether the total cost of the loan, namely interest plus options, in relation to the usury laws, is not unconscionable. The Court can refuse to enforce this purported contract, or can rescind it or reform it. In no circumstances, however, should Chemical Bank be given a secured interest in the assets of the Debtor.

As 14 Williston Sec 1632, p 49 notes:

> Equity recognized unconscionability as a ground for refusing its aid to a party alleging breach of contract long before the Uniform Commercial Code formulated a provision making 'unconscionable' agreements unenforceable.

Courts of Bankruptcy also have upheld this provision of contract law and refused to recognize unconscionable contracts. Re Chicago Reed Co. 7 F.2d 885 (CCA7). This power has been upheld by the United States Supreme Court, e.g., see Hume v. U.S. 132 U.S. 406. See also 1 Williston Sec. 115.

Indeed if this is not an unconscionable agreement - what is unconscionable. If there was no overreaching here, when was there ever overreaching. The Appellee Chemical Bank in effect took over the Debtor, while maintaining demand loans as demand loans.

Despite the overwhelming evidence that these agreements of Chemical Bank are unconscionable the Bankruptcy Judge held in the Supplemental Opinion of June 10, 1974 on page 4 that:

> One point raised in the reply brief dealt with the issue of unconscionability of some of the terms of the April 23, 1973 agreement (Applicant's Exhibit "C")-- Banks are not charitable institutions and traditionally require broad protection of their interests when entering into contracts. The terms of this contract (Applicant Chemical's Exhibit "C") follow that pattern, but it is not unconscionable.

The District Court in its decision of July 19, 1974 did not even bother to deal with the question of the unconscionability of these agreements.

The only possible sentence relevant to the matter is "The Court considers the debtor's remaining contentions to be without merit." (p. 7). Surely this matter requires more careful examination by the Courts for the agreement of April 23, 1973 is clearly unconscionable.

XI. THE AGREEMENTS OF APRIL 23, 1973 OF CHEMICAL BANK WERE OBTAINED BY THREATS OF ECONOMIC DURESS.

It should be noted that these alleged agreements of April 23, 1973 the Chemical Bank exhibits, were obtained by threats of economic duress against the Debtor as the uncontradicted testimony shows.

Contracts obtained by use of economic duress should clearly not be enforced by the courts. Contract obtained by duress are voidable and the contract of April 23, 1973 between Chemical Bank and the Debtor should be declared void.

The duress of the Appellee Chemical Bank continued to date of the entering Chapter XI proceedings by the Debtor.

> Under the modern rule now generally recognized a contract obtained by so oppressing a person by threats as to deprive him of the free exercise of his will may be avoided on the ground of duress whether or not the oppression causing incompetence to contract amounts to what was formerly deemed duress at law or merely wrongful conpulsion remedial in equity. (17 CJS 957).

See also Sylvan Mortgage Co. v. Stadler 185 NYS 293, 296, 113 Misc 659; Oleet v. Penn. Exchange Bank 137 NYS 2d 77[illegible] 285 App. Div. 411. The Oleet case has held that where a person is called on either to comply with demands or suffer a serious business loss, then the contract is invalid (See p 783).

The duress here, uncontradicted, was the means whereby Chemical Bank obtained such an onerous agreement from the Debtor. Therefore this contract should be invalidated. The Courts below did not consider this matter at all.

XII. THE CHEMICAL BANK CONTRACT IS ILLEGAL UNDER THE BANKING LAWS.

There is in addition to lack of consideration and unconscionability and duress some question as to whether this contract is legal under the Banking laws, since the provision of Paragraph 15 of Exhibit C gives the bank an interest in the Debtor that is in the nature of a security, namely a warrant. The warrants specified in paragraph 15, Exhibit C of Chemical Bank were delivered to the Bank concurrent with the alleged agreements. It is not lawful for Chemical Bank to have required these warrants and since the agreement is illegal it is void or voidable. See Federal Reserve Act, Sec 9 (Act of December 23, 1913, 31 Stat. 259; Act of June 16, 1933, Sec 5(C), 48 Stat. 165; 12 U.S. Code 335). While stock may be acquired for prior losses of a bank to recoup its losses, this does not mean the outright acquisition of a security interest in a corporation by way of warrants and in the case at bar as a part of a loan agreement at high interest, is permitted by law. Note that the acquisition of 30,000 warrants gave Chemical Bank a potential immediate interest in the Debtor upon exercise, in excess of five percent. Note also that the Debtor was a public corporation with its stock being traded over-the-counter.

> The governing statute denies national banks the right to invest its funds in stock of corporations, except as otherwise permitted by law. 4CCH Federal Banking Law Reporter (hereinafter "Bank Reporter") Paragraph 49, 119. 12 U.S. Code 24.

While there was no purchase in this case by the Bank, here the bank acquired this security interest and this interest does not fall under one of the exemptions of the code. (Sec. 4 CCH, Bank Reporter Paras 49, 120; 49, 121). The Courts hereinbelow did not deal with this aspect of the case.

To summarize, since the financial condition of May Lee was precarious from its inception, therefore, under the alleged overall agreement of April 23, 1973, Chemical Bank could call the loans at any time it wished to because in fact from an accounting point of view it could deem itself in jeopardy at any time. In fact, the uncontradicted testimony evidences the fact that Chemical Bank did on numerous occasions call its loans. The calling of the loans were used as a threat against the corporation. The original agreements were obtained by a threat, namely the threat to put the company out of business. Very often bank forms are construed against banks that use them. The agreement is also illegal under the Banking Laws, therefore, it is respectfully submitted that as a matter of law Chemical Bank does not have a security interest in the assets of the Debtor.

XIII. APPELLEE CHARTERED BANK HAS FAILED TO ADEQUATELY DESCRIBE THE COLLATERAL IN ITS SECURITY AGREEMENT.

The case built by both Appellees, throughout each hearing hereinbelow was based on the theory that a description of collateral was unnecessary since both Appellees could divide the entire assets of the Appellant between them. The reason that the Appellees decided to structure their case on this theory is that they clearly did not have an adequate description of collateral in their security agreements. The Appellees know this, the Appellant knows this, this has formed the basis of numerous discussions between the parties and yet the courts below have found the description of the collateral adequate. No party can identify the collateral belonging to Chartered Bank. How can the description of the collateral be adequate?

A Court Opinions Re Chartered Bank Description of its Collateral.

The original Opinion of the Bankruptcy Judge of May 17, 1974 in dealing with the description of collateral merely deals with the description in the financing statement of Chartered Bank. (See pages 8 and 9 of Opinion).

The Supplemental Opinion of June 10, 1974 dealt with this matter on page 3 stating:

> The security agreements each give a general description of the goods representing the collateral and refer to an attached invoice. These invoices are quite specific in describing the Collateral. The security agreements satisfy the Statutory requirement and are valid.

The District Court Opinion of July 19, 1974 incorrectly asserts the Appellants position and then on page 6 decides that:

> This Court, after examining the security agreements, concludes that the Bankruptcy Judge's finding that the description of collateral is sufficient to make possible the identification of the thing described is not clearly erroneous. His finding that the invoices were part of the security agreements is supported by the record and cannot be said to be clearly erroneous despite conflicting testimony on that issue. Moreover, the Court has considered tne debtor's other contentions regarding the insufficiency of the security agreements and concludes that Judge Galgay's remaining findings were not clearly erroneous and that his conclusions of law were correct.

B. Questions of Fact Raised By Court Decisions Re Chartered Banks Description of Collateral.

1. Reference to an Attached Invoice.

Judge Galgay held that the "...security agreements...refer to an attached invoice...." This is clearly incorrect. Some of the Appellees Chartered Bank's trust receipts refer to an attached invoice and some do not. It is most difficult to identify the Appellee, Chartered Banks documents because the ones submitted as part of their original petition for reclamation differ from the ones submitted as exhibits. For example in the fifth and seventh document attached to the original Appellee Chartered Bank's petition for reclamation of March 14, 1974 wherein 35 and 49 bales of carpets, respectively, are specified, there is no reference to an attached invoice. This is true of several of the documents. Therefore Judge Galgay was clearly incorrect in his holding.

2. Were Invoices part of the Security Agreements

The District Court held that the Bankruptcy Court's

> ...finding that the invoices were part of the security agreement is supported by the record and cannot be said to be clearly erroneous despite conflicting testimony on that issue. (p. 6)

The only testimony on that issue has been quoted hereinabove. There is no conflict with that testimony - only supporting testimony. The District Court is clearly in error when it refers to conflicting testimony on this matter - there is none. The only testimony shows that when these documents were presented to the Debtor they had no invoices attached. Those attachments were made later.

This is further verified by the fact that the attachment to the first trust receipt in the original petition differs from the attachment which was part of the exhibit of the same trust receipt introduced by the Appellee Bank. There is clear error in the lower Court ruling hereinbelow.

3. Were Invoices Attached

Both Judge Galgay and the District Court have held that invoices were attached to the trust receipts. This is incorrect. For example the first trust receipt attached to the original Peition for Reclamation of Chartered Bank has a customs invoice attached to it. This is not an invoice. The Court's below are clearly in error here.

4. The Trust Receipts Adequately Describe the Collateral in Fact.

The 39 trust receipts in their description of the collateral read as follows:

1. 1 Package Jewelry
2. 13 Pkgs. Paintings
3. 1 Pkg. General Merchandise
4. 89 Bales Carpets
5. Blank
6. 44 cases Bamboo Products
7. 49 Bales Carpets
8. 4 cases Bamboo Articles
9. 2 Bales Carpets
10. 25 cases Furniture & Screens
11. 46 packages Mats
12. 10 Pkgs. Straw & Bamboo wares
13. 55 Pkgs. Pigskins
14. 3 cases Lacquer wares
15. 20 ctns. Dinner Sets
16. 53 Bales Carpets
17. 17 Bales Carpets
18. 8 packages Toys
19. 92 pkgs. Bamboo Wares
20. 43 ctns. Glassware
21. 1 case Silk Sheet
22. 31 cartons Bamboo
23. 29 cases Assorted Lacquerware
24. 6 Bamboo cases of Bamboo trays
25. 74 cases Bats & Balls
26. 63 ctns. Bags & Baskets
27. Shipment of Assorted Straw Goods
28. Assorted Lacquered Furniture
29. 20 Bales Carpets
30. Assorted Straw Mats
31. 12 Cases Bamboo Braiding
32. Assorted Furniture Cabinets
33. 25 cases Sporting Goods
34. Incense Sticks
35. 19 cases Hand Painted Scrolls
36. 26 cartons Straw Baskets
37. Blank
38. 2 pkgs. Cotton Crochet & Chenille Articles
39. 16 Bamboo Wares

This description is not at all adequate. Note that some like trust receipt 5 has no description of the collateral. This is also true of trust receipt 37. The remaining trust receipts have such a brief description of collateral as to be meaningless. No one can identify the goods referred to by these descriptions, which is why the Chartered Bank and Chemical Bank have refused to do so, but claim they own it all.

5. The Attachments to the Trust Receipts Adequately Describe the Collateral.

The implication of the Opinion of the Bankruptcy Judge and the District Court is that while the trust receipts may not adequately describe the collateral, when the so called "invoices" are added the description is adequate. The Supplemental Opinion of June 10, 1974, p. 3 goes so far to

state:

"The invoices are quite specific in describing the collateral." These so called "invoices" which are inadmissable, at times only help slightly to clarify the description and at times fail to clarify it at all.

For example the first attachment to the first trust receipt in the Appellee Chartered Bank's petition of March 14, for reclamation merely states: "one (1) pck containing silver plated costume jewelry". How can anyone identify the jewelry from that. Thus the invoices are not "quite specific" and Judge Galgay is clearly wrong.

The third attachment to the third trust receipt says "General Merchandise Samples & Goods as per Contract No. 3AAPU026" Is that quite specific?

Several trust receipts and attached documents refer to carpets. None of the descriptions in the attachment would help us or Chartered Bank identify the ones to which the trust receipt and attachment apply, for Chartered Bank must know the ground color, border color, design, size, quality, fiber content, and delivery date and lot to even begin to pick them out.

The decisions hereinbelow are not at all correct - but rather quite clearly in error.

C. Questions of Law Raised by the Court.

In addition to the factual inadequacy of the Courts decision, and adequacy of description of collateral is in part a matter of fact, the court

decisions below are clearly incorrect as a matter of law.

1. Description of Collateral in Law.

A security agreement must contain a description of the collateral in order to be enforceable (UCC Sec. 9-203), it must be a valid agreement (UCC Sec. 9-201), it must give the Debtor rights to the collateral (UCC Sec. 9-204), it must be in writing and signed by the Debtor (UCC Sec. 9-203(1)(b)). Only if these and certain other requisites are met does the security interest attach as between the Debtor and the potentially secured party. Several writers have noted that:

> There must be a security agreement...delineating the precise collateral or the type of collateral involved....(Lester E. Denon, Secured Transactions Under the UCC, (Practicing Law Institute, 1970) at p. 39)

While the courts and commentaries have rejected the so called "serial number" test (See UCC Comment Sec. 9-110) the description must "...make possible the identification of the thing described." The official commentary provides:

> The requirement of description of collateral (see Section 9-203 and Comment thereto) is evidentiary. The test of sufficiency of a description laid down by this Section is that the description do the job assigned to it--that it make possible the identification of the thing described. Under this rule courts should refuse to follow the holdings, often found in the older chattel mortgage cases, that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called "serial number" test.

The official commentary to Section 9-203 of the UCC states:

3. One purpose of the formal requisites stated in subsection (1)(b) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stand as collateral for the obligation secured.

5. The formal requisites stated in this Section are not only conditions to the enforceability of a security interest against third parties. They are in the nature of a Statute of Frauds. Unless the secured party is in possession of the collateral, his security interest, absent a writting which satisfies subsection (1)(b), is not enforceable even against the debtor, and cannot be made so on any theory of equitable mortgage or the like. If he has advanced money, he is of course a creditor and, like any creditor, is entitled after judgment to appropriate process to enforce his claim against his debtor's assets; he will not, however, have against his debtor the rights given a secured party by Part 5 of this Article on Default.

Therefore the law is very clear. The precise collateral must be described. The descriptions are not inadequate "...unless they are of the most exact and detailed nature...." (UCC official Commentary Sec. 9-110) but a "written record" is required sufficient to "...minimize the possibility of future disputes as to the terms of a security agreement and as to what property stands as collateral for the obligation secured." (UCC official Commentary Sec. 9-203).

Here the test is so far from met that this matter should have been decided hereinbelow. The entire reason behind the Appellees theory that they do not have to prove which collateral belongs to them is because they cannot identify their collateral. They have refused to identify their collateral because they cannot identify it.

How can anyone identify "general merchandise" or "one pkg

jewelry" or "49 Bales rugs'. No one knows to what these inadequate descriptions apply. Obviously "future disputes" have not been "minimized" but rather maximized by the Chartered Banks inadequate descriptions.

As the Official Commentary to UCC 9-203 states:

> If he has advanced money he is of course a creditor...he will not, however, have against his debtor the rights given a secured party....

This applies to Chartered Bank and Chemical Bank. The test as the Commentary states is evidentiary. They have failed to meet the test and indeed refused to meet the test. Chartered Bank is not and cannot be a secured creditor of the Appellant Trustee.

XIV. APPELLEE CHARTERED BANKS SECURITY INTEREST WAS NOT PERFECTED.

The only portion of the case that has been dealt with by the Courts hereinbelow is the question of whether or not the security interest of Chartered Bank was perfected by proper filing and indexing of a financing statement. The District Court in particular on pages 3, 4 & 5 of its Opinion has dealt with the legal issues raised here. Unfortunately the Appellant respectfully submits that the decision of the District Court on this matter is incorrect.

A. Review of the Facts Re the Filing in New York County of Financing Statement.

As was illustrated supra the facts and uncontradicted testimony

at the hearings was that no one could find a financing statement for Chartered Bank in the New York County Registers office at any time prior to the debtor entering Chapter XI proceedings. The Appellants employee, the employees of the New York County Registers office, the Inter-County search, a creditor of May Lee's search,all failed to find such a filing prior to the Chapter XI. In addition evidence was introduced to show that the debtor had relied upon the filings at the suggestion in part of Chemical Bank.

B. Legal Requirements of a Filing.

1. Place of Filing

Even if the security agreement was valid as between the Appellant and Chartered Bank, the bank would still not be a secured party unless it perfected its security interest. Perfection in this case would have to be by filing (UCC Sec. 9-302).

The proper place of filing under the UCC Sec. 9-401 is in the office of the Secretary of State and in addition in the county where the Debtor has his place of business, namely New York County.

2. Sufficiency of Financing Statement

In order to perfect a filing, a proper instrument must be filed at the designated locations. (UCC Sec. 9-402) The Chartered Bank filing failed to meet the minimum requirements of the law for the following reasons:

(a) The description of the collateral contained in a financing statement must indicate the types or describe the items of collateral. (UCC Sec. 9-402(1)). The description in the Chartered Bank financing statement allegedly made with the Secretary of State is defective in several ways. It states, "Documents of title and/or goods...." Since on information and belief May Lee, the Appellant has possession of neither documents of title nor documents of goods from any relations with Chartered Bank, therefore the statement covers no collateral in the possession of May Lee, the Appellant.

(b) Secondly, the card in the alphabetic file, which has only been present subsequent to the filing of these proceedings in arrangement, does not include a check mark for proceeds or products of the collateral. Therefore the bank's application for proceeds in Paragraph 12 and in the Wherefore clause of the bank's petition must fail.

3. Filing

The code specified in UCC Sec. 9-403(4) that:

> A filing officer...shall hold the statement or a photographic or microfilm copy thereof for public inspection....

Since this was not done in New York County as shown hereinabove and in the affidavits of Laura Santangelo and David C. Buxbaum, the filing was not perfected.

C. Holding of the Cases

Numerous relevant cases have been decided in this jurisdiction, New York, in both federal and state tribunals and in sister tribunals. To illuminate the statute, relevant cases shall be discussed hereinbelow.

In the case of John Deere Co. of Baltimore v. William C. Pahl Construction Co., 59 Misc. 2d 872, 300 N.Y. 2d 701 (1969) the Supreme Court of N.Y. held that:

> Section 9-402 adopts a system of 'notice filing' which merely indicates that the secured party which has filed may have a security interest in the collateral described.... The secured party has the duty to make sure of proper filing and indexing. (300 N.Y. 2d 701 at 703) (emphasis supplied).

In the case at bar there was no notice to anyone and since this is a notice statute Chartered Bank failed to perfect its filing.

Logically the duty to insure proper filing was placed upon the potentially secured party and the filing at the Secretary of State's office misspelled the name Ranalli, spelling it as Ranelli. While the court held that "Immaterial error" should not affect the filing:

> In this day of volume filing, the exact spelling of the debtor's name is essential... since those where an exact spelling is not present on the financing statement may not necessarily be shown on a search. (300 N.Y. 2d 701 at 703, 704).

The security interest of the plaintiff was thus held ineffective as to the defendant in possession.

The court interprets the statute as follows at p. 702, 703:

> The applicable statute is contained in Article 9 of the Uniform Commercial Code. Under the Statute, a financing statement

> must be filed in order to protect a security interest in property not retained by the creditor (9-302);...filing consists of the presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer (9-403(1)). The statement is indexed by the filing officer according to the name of the debtor (9-403(4)); a security interest is perfected when all the applicable steps for perfection have been taken (9-303(1)). (emphasis supplied).

In the Deere case the filing in Onondaga County was correctly spelled and accepted but since two filings were required, as in this case, and the one in the Secretary of State's office was not properly filed, the court held that the security interest had not been perfected.

In this case Chartered Bank did not perfect its filing since the statement had not been indexed by the filing officer according to the name of the Debtor in New York County. The duty was that of Chartered Bank, to insure proper indexing and failure to do so left them with an unperfected interest and thus not secured.

The Appellate Division of the Fourth Department sustained the Supreme Court of Onondaga County (310 N. Y. 2d 945 (1970)). The Appellate Division held that:

> ...the purpose of a notice-filing statute is to afford protection to a creditor by furnishing others who intend to enter into a transaction with the debtor a starting point for investigation which will result in fair warning concerning the contemplated dealing with the debtor. (at 948).

The debtor in possession stands in the position of a hypothetical lien creditor in this case and since the Chartered Bank did not have a filing in New York County, the security interest of the bank was not perfected. The court held

at p. 949 that compliance with

> ...the requirements of Section 9-402 is a question of law and not of fact, which turns on what a standard search would disclose... (emphasis supplied)

A standard search in this case, prior to the Chapter XI filing, disclosed that Chartered Bank did not file in New York County. The searches in the Deere case were tainted, having been made after litigation, and the court did not give them weight. The two searches in this case were made prior to litigation and in one case by an independent reputable third party. No filing was found for Chartered Bank in New York County and thus there was no notice and Chartered's security interest is invalid.

In another case, a bankruptcy matter, In the Matter of Henry Platt 257 F. Supp. 478 (1968) the U.S. Dist. Ct. for the E.D. of Pennsylvania held at p. 432 that:

> The secured party has the duty to make sure of proper filing and indexing. (emphasis supplied).

The court notes that in a bankruptcy situation the rights of a trustee and creditors are ascertained as of the date the petition was filed (at 481) and the trustee has the rights of a lien creditor on all property upon which a creditor could have obtained a lien whether or not a lien creditor actually exists (at p. 480, 481). In the Platt case a name, including the last name of the debtor, was used in the filing and the court held since it could be found in the records it was not seriously misleading.

In a New Jersey case that applied the New York statute Bank of North America v. Bank of Notley 227 A 2d 535 (1967) the court also held at p. 537 that the security interest was perfected when all applicable steps were

taken. The court included the indexing of the statement by the filing officer according to the name of the debtor as one of the applicable steps to be taken for perfection of the filing. The register filed the statement under Joseph Kaplas although where the name was printed in the filing it was Joseph Kaplan, the debtor's actual name, and only the signature could be read as Kaplas. The court held that filing under Kaplas was fatal.

The U.S. District Court for the N. D. of Calif. in another bankruptcy action upheld the Referee's action and held that where the error failed to provide notice to potential creditors, the filing was not perfected. (In the Matter of Burris Haley Thomas 310 F.S. 338 (1970)). The Ninth Circuit Court of Appeals in the same case 468 F. 2d 51 (1972) held that where the filing was under the debtor's trade name and not real name, that no notice was given to potential creditors. The court held at p. 53:

> The secured party, not the debtor or uninvolved third parties, has the duty of insuring proper filing and indexing of the notice. (emphasis supplied).

The fact "...that no actual creditor was misled..." was held "not determinative" (at p. 53). The trustee was regarded as the ideal hypothetical lien claimant as of the date of the bankruptcy (p. 53). Since an ideal hypothetical lien creditor would not have discovered the lien by examining the index it was held invalid. This case is also applicable to the case at bar, since the duty is on the secured party, not on the debtor or uninvolved third parties to insure the fact that the lien was perfected and filed properly. The fact that Chartered Bank did not act until after the Chapter XI Application proves

that the bank could have perfected its filing if it acted sooner and that its failure to act earlier was fatal. Whatever claims the bank may have against others, it has no secured claims against the Debtor-in-Possession, May Lee Industries, Inc., the Appellant.

See also In Re Uptown Variety 6 UCC Reporting Service 221 (1969) U.S. Dist. Ct., D. Ore. where trustee prevailed against a misfiled statement where the court held it was not up to the clerk to construe the filing.

D. Opinions of the District Court Analyzed.

The District Court on page 4 of its Opinion states that:

> The date stamp and filing number on the financing statement are primia facie evidence of filing on that date; the only evidence offered in rebuttal is that later it temporarily could not be found.

The facts are that the filing in New York County of Chartered Bank could not be found at all until after the Chapter XI proceedings were commenced.

1. Primia Facie Case

While Appellant agrees that the Appellee Chartered Bank offered primia facie evidence of a proper filing - once it was shown that no filing could be found, it was the duty of the Appellee Chartered Bank to come foward and explain its lack of filing in the files. Chartered Bank not only refused to do so but wrongfully moved to bar legitimate evidence from being introduced as shown hereinabove.

2. Duty of Filing

The District Court quotes the Commentary to Section 9-407 of the UCC as if it were the Commentary to Sec. 9-403. In addition the District Court Opinion fails to note that New York law was amended, and Section 9-403(4) was changed and the commentary quoted to 9-407 did not necessarily contemplate that change. In any event, however, the cases have clearly held in New York that

> The secured party has the duty to make sure of proper filing and indexing. (300 N. Y. 2d 701 at 703).

3. Mistakes by Filing Officer

The District Court thereafter quotes the In Re Royal Electrotype Corp 485 F 2d 394 as if it were relevant to this case. There has been no evidence introduced in this case that any filing officer made an error. If the filing officer made the error then perhaps, and only perhaps, the Chartered Bank would have sustained its burden of proof. Appellee Chartered Bank never went foward and proved that the filing officer made a mistake, may have made a mistake, or misfiled the filing. Its entire thrust was to argue that the filing was really there all along although it introduced no such evidence.

Therefore, it is respectfully submitted, that Appellee Chartered Bank never perfected its security interest, and it is not a secured party. It never met its burden of proof. It is also clear that in no event does Chartered Bank have an interest in the proceeds from sale of any collateral since it did not mark the proper box to designate its interest in proceeds

in the financing statement.

CONCLUSION

The Appellant respectfully submits that based on the foregoing, neither Appellee is a secured creditor of the Appellant-trustee and that therefore the Appellant prays that the decision and order of the District Court of July 19, 1974 and the Order of the Bankruptcy Judge of June 14, 1974 should be set aside and a decision rendered for the Appellant, holding that neither Appellee is a secured party, together with the costs and disbursements of this action.

Respectfully submitted,

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DATED:
July 30, 1974

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

In the Matter -of- MAY LEE INDUSTRIES, INC., Appellant. (In Proceedings for An Arrangement No. 74-B-166)	Docket No. 74-1982 AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

FLORENCE PI, being first duly sworn, deposes and says:

That deponent is not a party to the action, is over 18 years of age and resides at 566 7th Street, Brooklyn, New York.

That on the 30th day of July 1974, at No. 230 Park Avenue, New York, New York deponent served the within Brief for Appellant, Trustee on Appeal from Order of District Court on appellee therein named, by delivering a true copy of such Brief to said appellee via their attorneys OTTERBOURG, STEINDLER, HOUSTON & ROSEN, P.C., attorneys for CHEMICAL BANK, personally; deponent knew the persons so served to be the attorneys for the appellee described therein.

Florence Pi
FLORENCE PI

Sworn to before me this
30 day of July 1974

DAVID C. BUXBAUM
Notary Public, State of New York
No. 24-0524590
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1975

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

In the Matter -of- MAY LEE INDUSTRIES, INC., Appellant. (In Proceedings for An Arrangement No. 74-B-166)	Docket No. 74-1982 AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

LAURA SANTANGELO, being first duly sworn, deposes and says:

That deponent is not a party to the action, is over 18 years of age and resides at 415 Stratford Road, Brooklyn, New York.

That on the 30th day of July 1974, at No. 67 Wall Street, New York, New York deponent served the within Brief for Appellant, Trustee on Appeal from Order of District Court on appellee therein named, by delivering a true copy of such Brief to said appellee via their attorneys HAWKINS, DELAFIELD & WOOD, attorneys for CHARTERED BANK, personally; deponent knew the persons so served to be the attorneys for the appellee described therein.

Laura Santangelo
LAURA SANTANGELO

Sworn to before me this
30 day of July 1974

DAVID C. BUXbAUM
Notary Public, State of New York
No. 24-0524590
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1975